CALTEX
Caltex Australia

Facsimile

Date: 28 March 2003

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From: Barry Palmer Tel: 02 9250 5885

Message Priority: x Urgent Routine No. of Pages (including cover): 41

Subject: **Caltex submissions to the ACCC in respect of Applications for Authorisation A 30224 and A30225**

CALTEX
Caltex Australia

28 March 2003

Mr Paul Palisi
General Manager
Adjudication Branch
Australian Competition & Consumer Commission
PO Box 1199
Dickson ACT 2602

Subject: **Response to Applications for Authorisation Nos A30224 and A30225 in relation to EFTPOS interchange fees. Sent by fax to 02 6243 1211 and by e-mail to adjudication@accc.gov.au**

Dear Mr Palisi,

Please find attached two versions of Caltex's submissions to the ACCC in response to the above Applications marked "ACCC Version (Contains Confidential Information)" and "Public Version (Confidential Information removed)".

Should you require further information on Caltex's submissions please contact me on 02 9250 5885 (direct line) or 0412 064 454.

Yours sincerely

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APPLICATION FOR AUTHORISATION: MULTILATERAL SETTING OF EFTPOS INTERCHANGE FEES

Caltex submissions

28 March 2003

CALTEX

Application for authorisation: Multilateral setting of EFTPOS interchange fees

Executive Summary

1.1 Introduction

The Commission is asked to authorise the making of and giving effect to a contract between 12 financial institutions to set EFTPOS interchange fees multilaterally.

The Commission cannot grant an authorisation unless it is *satisfied* in the circumstances that the proposed contract would result or would be likely to result in a benefit to the public which would outweigh the detriment to the public constituted by any lessening of competition that would result or would be likely to result if the proposed contract were made, and given effect.

1.2 The Commission cannot be 'satisfied'

The application for authorisation does not provide any factual, theoretical or economic basis upon which the Commission could be so satisfied. Caltex[1] submits that the proposed arrangements will substantially lessen competition in at least two markets, the alleged public benefits are illusory, and the public detriment far outweighs any public benefit.

Firstly, and fundamentally, the application provides no analysis of relevant markets, competitive effects, or public benefits or detriment. It relies in its entirety on views expressed in the Reserve Bank of Australia/ACCC October 2000 Joint Study on Debit and Credit Card Schemes in Australia (the ***Joint Study***).

The Joint Study does not provide any basis upon which the ACCC could be satisfied that the public benefit of the proposed price fixing arrangement outweighs the public detriment of that arrangement.

1.3 Relevant Markets

There are at least two relevant markets in which the competitive effects of the proposed arrangement must be analysed:

(a) the market for clearing and settlement arrangements for EFTPOS transactions between issuers and acquirers (the ***issuer/acquirer market***).

(b) the market in Australia for the provision by merchants who have their own card processing (including EFTPOS) infrastructure of access to acquirers (the ***merchant network /acquirer market***).

1.4 Effect on Competition in the Relevant Markets

The proposed arrangement is a price fixing arrangement, which is deemed by s45A of the TPA for certain purposes to have the purpose or effect of substantially lessening competition.

Caltex is not a participant in the issuer/acquirer market, but submits that a move from a large number of independently negotiated bilateral commercial agreements between EFTPOS network participants (the Joint Study reports 39 such arrangements) to a single multilateral price fixing arrangement must, by definition, have the effect of substantially lessening competition in the market for those services.

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[1] Caltex Australia Petroleum Pty Ltd: For the purposes of this submission, Caltex 'sites' includes company operated, franchise and distributor sites operating under the Caltex, Ampol or other brands.

Caltex is a participant in the merchant network/acquirer market. This market is a competitive market, with merchant networks going out to tender to acquirers to provide network access. The level of network access fee offered to be paid by acquirers is a key element in evaluating bids. Competition in this market will be substantially lessened, as a key element of the pricing discretion available to acquirers will be removed by the proposed multilateral price fixing arrangement.

1.5 Alleged Public Benefits

Caltex submits that the public benefits which the applicants predict will flow from the proposed arrangements are at best overstated, and at worst non-existent.

Each of the public benefits claimed by the applicants is underpinned by an assumption that there is currently a problem which needs to be fixed; namely, a 'distortion' which encourages use of credit cards at the expense of debit cards. No evidence of this so-called imbalance is provided, the applicants relying utterly on 'the reasoning' in the Joint Study. Caltex asserts that the current debit card interchange arrangements are not distorted, and that, in so far as debit cards are concerned, there is no 'imbalance' which needs to be addressed.

The proposed arrangement is likely to create a distortion rather than remove one. It simply moves costs from one place to another. The application acknowledges that costs will freely move elsewhere with a result '*the total cost to consumers and merchants of using EFTPOS will be unchanged*' and '*the reform of interchange fees would then be effectively 'neutral'*'[2]. It is submitted that a movement in costs from issuers to merchants and/or end consumers is not a public benefit.

The applicants claim that the arrangement will introduce greater flexibility into the setting of EFTPOS interchange fees. How a multilateral price fixing arrangement subject to annual review is more flexible then freely negotiated individual bilateral arrangements is not explained. Caltex submits the proposed arrangement will reduce, not increase, its flexibility to negotiate with acquirers.

The applicants also allege removing price as an element of bilateral negotiation between issuers and acquirers will make entry as a new issue or acquirer of EFTPOS transactions easier. Caltex submits that there is no evidence that price negotiation is a barrier to new entry and that in any event a new entrant would still be faced with negotiating bilaterally in relation to all non-price matters.

1.6 Public Detriment

The proposed arrangement will cause substantial public detriment which the application for authorisation ignores. The most important of these is that the incentive for merchants such as Caltex to invest in infrastructure will be substantially decreased.

The strong possibility of serious adverse investment consequences is acknowledged in the application for authorisation: '*the investment effects of lowering interchange fees remain unclear*'. The applicants seek to minimise this detriment by agreeing to '*monitor the proposed arrangements each year to determine whether they are causing unforeseen effects or inequities*' and providing for '*the possibility of an early review if there was a material change in circumstances (which would include any significant drop in investment in EFTPOS)*'.

Caltex submits that this concession is an admission that the applicants anticipate that a significant drop in investment with consequent degradation over time of the EFTPOS system is a likely consequence of the proposal. On that basis alone, the Commission cannot be satisfied that public benefits will outweigh the detriments.

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[2] Applicants submission, p17

Onus of Proof

2. The Onus of proof

2.1 The test

The test upon which the Commission must determine the application is contained in section 90(6) of the TPA. The Commission 'shall not' grant authorisation 'unless it is satisfied in all the circumstances' that the proposed arrangement:

(a) *'would result, or be likely to result, in a benefit to the public'*; and

(b) *'that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result'* from the proposed arrangement.

As a matter of general approach, the relevant comparison to be made is between the position in future if the proposed arrangement were not entered into with the position in future if it were[3]. Claimed public benefits must be shown to result or be likely to result from the proposed arrangement. The word 'likely' has been interpreted to require a consideration of 'commercial likelihoods' and that there must be a tendency or real possibility of a particular result[4]. The Commission must consider all the circumstances that relate to the public benefit including how the proposed arrangement is likely to operate in practice so as to give rise to public benefit[5].

The major reasons for the failure of authorisation applications over time were accurately summarised by the TPC's 1977 Annual Report as including that no public benefit is established. Caltex submits that this is the case with the current application.

The evidence submitted by the applicants does not support the applicants' contentions of public benefits. Indeed, the applicants make no serious attempt analytically to substantiate their arguments at all; preferring instead to rely on the Joint Study which suffers from a number of inadequacies (summarised in section 7 below). As was noted by Northrop J in *Re Howard Smith*[6]:

> *general statements about possible or likely benefits are not usually helpful to the Tribunal in making its assessment if they cannot be backed up by some factual material.*

Even if some public benefit can be perceived, Caltex submits that the Commission could not in all the circumstances be 'satisfied' that the benefit would 'outweigh' the detriment constituted by the lessening of competition that would be likely to result. The application does not deal with the markets in which an anti-competitive detriment will be felt, and there is no attempt to do anything more than assert that there will no or minimal anti-competitive detriment.

The applicants themselves do not know what effect their proposal will have. They state that '*the investment effects...remain unclear*'[7] and seek to address this by monitoring the situation each year

[3] Re Tooth & Co (1979) 39 FLR 1 at 23.

[4] Re Howard Smith (1977) ATPR 40-023.

[5] Re Media Council of Australia (no 2) (1987) ATPR 40-774.

[6] Re Howard Smith (1977) ATPR 40-023 at 17,334.

[7] Applicants Submission, p17

for '*unforeseen effects or inequalities*'[8]. In a situation where the applicants themselves are unclear as to the consequences of their proposal, the Commission cannot be satisfied that the public benefits which the applicants allege will flow from the conduct will outweigh the competitive detriments.

[8] Applicants Submission, p17

3. Caltex & EFTPOS

3.1 Caltex

As the applicants note in their submission, '*use of EFTPOS in Australia was initially moderate, but grew rapidly in the early 1990s when several major retailers joined the network*'.

Caltex was at the forefront of this move; indeed the first application of EFTPOS in a retail situation occurred in 1984 at an Ampol (now Caltex) service station in Melbourne. Initially the facility was only available to customers of National Australia Bank. Caltex was involved in initiatives during 1984 and 1985 to persuade the banks to provide interchange services, so that EFTPOS facilities could be used by customers of any bank.

Caltex has invested more than $[confidential] in EFTPOS facilities since 1991[9]. In 2001, some [confidential] Caltex sites across Australia processed a total of [confidential] card transactions of which [confidential] were EFTPOS transactions. This represents almost [confidential]% of all EFTPOS transactions in Australia.

The equipment that it has installed includes:

- card terminals
- secure PIN pads
- driveway card acceptance devices at some sites
- front end processors and switches
- communications networks.

As in all cases where high technology is involved, Caltex faces considerable costs to keep EFTPOS equipment maintained and to meet enhanced processing requirements. Equipment at point of sale needs to be replaced over a [confidential] year life cycle, a considerable capital cost to Caltex. In addition, Caltex estimates its annual cost of maintenance of EFTPOS infrastructure exceeds $[confidential][10].

System updates are also ongoing, and in many cases are mandated . For example there is a requirement by APCA to upgrade security to Triple-DES standard by the end of 2005. This is an upgrade to reduce card fraud for the benefit of the card issuers and it will cost Caltex an estimated $[confidential] by the end of 2005 to replace existing PIN pads with Triple-DES compliant hardware.

The applicants assert that '*the introduction of higher security on transactions or greater functionality of cards might require large capital investment in new equipment by issuers, acquirers and possibly some merchants*'. However, higher security has already been mandated by

[9] This figure does not include costs associated with StarCard and credit cards. Costs of shared infrastructure have been apportioned on the basis of transaction numbers.

[10] Once again, this figure excludes costs apportioned to credit card and StarCard in relation to maintenance of shared infrastructure.

APCA and merchants such as Caltex have been advised that they must upgrade their systems if they wish to remain within the EFTPOS system. Furthermore, banks and card schemes are already considering other technical enhancements to EFTPOS infrastructure to minimise fraud such as the move to chips on cards which will be significantly more expensive; Triple-DES will not be the end of the story in terms of infrastructure upgrades and cost.

[confidential]

[confidential] [11]. Indeed, the applicants concede that this is the most likely consequence of their proposal[12]:

> *'following the loss of interchange fee revenue caused by the adoption of zero interchange fees, it is likely that acquirers will seek to recover the cost for providing merchant acquiring services from other revenue sources...'*, resulting in *'higher average [merchant service] fees and increased marginal transaction charges for accepting EFTPOS'*.

[confidential] Caltex submits that this will create an unsustainable commercial situation; putting Caltex's current investment in jeopardy and making future investment in EFTPOS infrastructure uncertain.

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[11] [confidential]

[12] Applicants submission, pp 15-16

4. Affected markets

4.1 Relevant markets

Although the applicants' submission fails to provide any market analysis, Caltex submits that there are at least four markets affected by the proposed arrangements:

(a) the issuer / acquirer market (which is the market for the clearing and settlement arrangements for EFTPOS transactions between debit card issuers and acquirers;

(b) the merchant network / acquirer market (which is the market for the provision by merchants who have their own card processing (including EFTPOS) infrastructure of access to acquirers);

(c) the merchant / acquirer market (which is the market for provision of processing and settlement of card transactions (including EFTPOS) between acquirers and merchants); and

(d) the issuer / cardholder market (which is the market for provision of debit account services by financial institutions to customers).

Caltex submits that the proposed arrangements, if authorised, are likely to have an anti-competitive effect in the issuer / acquirer market and the merchant network / acquirer market. These are considered in turn below.

4.2 Issuer / acquirer market

The interchange or issuer/acquirer market is the market for the clearing and settlement arrangements for EFTPOS transactions between debit card issuers and acquirers.

Caltex is not a participant in the issuer/acquirer market and its comments are necessarily limited. However, Caltex notes that the TPA has seen fit to deem price fixing arrangements to have the effect or likely effect of substantially lessening competition for the purposes of section 45. This recognises that price arrangements are inherently anti-competitive.

A move from a large number of bilateral agreements to a single multilateral pricing arrangement removes any possibility of price variation (as it currently exists) and must deliver a less competitive outcome than the existing bilateral arrangements.

4.3 Merchant network / acquirer market

The merchant network/acquirer market is the market in Australia for the provision by merchants who have their own card processing (including EFTPOS) infrastructure of access to acquirers.

Caltex is a merchant with its own card processing network. It provides access to its network to an acquirer to enable the acquirer to process and settle card transactions that flow through the Caltex network. Under current arrangements a network access fee is paid by acquirers to merchant networks.

That market is a competitive market, with banks and financial institutions vying with each other to obtain access to a merchant's network. Caltex, which is responsible for almost [confidential]% of all EFTPOS transactions in Australia, is an attractive network for these institutions. How the market works can be best explained by Caltex's experiences in the market place over the last few years.

4.4 The 1997 Tender

[confidential]

4.5 The 2002 Tender

[confidential]

4.6 The effect on competition in the merchant network/acquirer market.

[confidential]

Caltex submits that moving to multilateral interchange fee setting would remove a key element in the pricing discretion able to be exercised by acquirers. It is likely that a multilaterally fixed interchange fee will lessen competition in the merchant network / acquirer market by tending to equalise the network access fee offered by acquirers to merchant networks.

5. Claimed public benefits

5.1 Claimed public benefits

The Applicants identify three public benefits which they argue arise from the proposed multilateral price fixing arrangements:

(a) making EFTPOS more attractive to consumers relative to less efficient means of payment, particularly credit cards;

(b) introducing greater flexibility into setting EFTPOS interchange fees, and reducing the inertia that has made them unresponsive to changes in market circumstances; and

(c) making entry as a new issuer or acquirer of EFTPOS transactions easier by simplifying negotiation of bilateral interchange agreements.

Each alleged public benefit is examined below. However, an important general point needs to be understood in relation to each of the alleged public benefits; the benefit alleged in each case is that the proposed arrangement fixes a problem identified in the Joint Study[13]. The difficulties in relying on the Joint Study are examined in section 7 below.

The problem found by the Joint Study and identified by the applicants[14]:

> *'does not lie with the EFTPOS system itself, but with a 'mismatch' between the allocation of costs in EFTPOS, as supported by the current interchange fee arrangements, and the allocation in other means of payment'.*

Caltex submits that the applicants have not demonstrated that a *'problem'* exists, and solving a non existent problem is not a public benefit.

The applicants have provided no basis on which the Commission could be satisfied that an arrangement which is likely to eliminate payment of a network access fee to merchants like Caltex for access to the network by an acquirer removes rather than introduces a distortion in the payments system.

The application concedes that the perceived problem is a distortion between different payment (debit card and credit card) systems based on the Joint Study. Credit card interchange fees are to be reduced under the RBA's designation so the perceived 'distortion' arguably will in future no longer exist. The Chairman of the Commission has himself felt the impact of the credit card interchange reform on price signals as between credit and debit card systems, noting recently in response to a question on credit card interchange[15]:

> *I would think that the incentives would mean that I would use a debit card more than I do at the moment.*

[13] See Part 3 of the Applicant's submission entitled 'What is the problem?', p9

[14] Applicants submission, p9

[15] Professor Fels responding to a question by Greg Hoy on ABC's '*Inside Business*' on 2 March 2003.

5.2 Public benefit of increased use of EFTPOS

The applicants assert that it is likely that effective competition between issuers will result in cost savings being passed back to debit card holders. The argument runs that competition should ensure cardholders face lower charges for the marginal debit card transactions over their fee-free allowance[16]. Caltex challenges this assertion on two bases:

(a) There is no evidence, either historical or in terms of the intention of the applicants, presented by the applicants to support the contention that competition in debit card issuing is sufficiently fierce that financial institutions would pass savings through to debit cardholders. No assurances are given. No timetables are suggested.

(b) The majority of debit cardholders at present pay no per transaction fees in relation to debit transactions. This is a consequence of the commercial model applied almost uniformly by issuers to allow cardholders a number of 'free' transactions per month. The 'normal' number of fee-free transactions across financial institutions is 8 per month (this includes ATM cash withdrawals and EFTPOS transactions)[17]. This translates to 96 fee free transactions per annum. In 2002, the average account conducted 38 EFTPOS transactions and 30 ATM transactions[18]. In short, the average account holder rarely pays a transaction fee. In addition, many account holders are exempted from paying fees; for example, students, home loan borrowers and pensioners. It is plain that most users rarely exceed their fee-free threshold and would not benefit from the savings to be 'passed on' by issuers.

The applicants also assert that effective competition in retailing is likely to see merchants recover their higher costs through a general inconsequential increase in prices of goods and services rather than through surcharges for use of EFTPOS. Caltex challenges two assumptions implicit in that assertion:

(a) A cost increase to retail consumers, even if it can be characterised fairly as 'inconsequential', is not a public benefit. A logical consequence of a likely general increase in the price of goods is that price signals in relation to the use of a particular mode of payment will be suppressed. Caltex submits that the Commission should not accept the applicants' submission that suppression of pricing signals to users of debit card is for the public benefit.

(b) The applicants assume that credit transactions will always be more expensive than debit transactions for merchants to process[19]. On the applicants own view, acquirers are likely to raise per transaction merchant service fees for debit transactions so as to replace the income stream from interchange fees. If the proposed credit card interchange reforms come into effect then the ad valorem transaction charge paid by merchant to acquirers on credit transactions is likely to fall. Accordingly, the proposed arrangements for smaller transaction values will be an incentive to merchants to encourage use of credit cards and discourage use of debit cards. This precise effect cannot be quantified because of the uncertainties in likely fee levels (which is itself a reason that the Commission cannot be 'satisfied' in the relevant sense) but the theoretical problem is undeniable and undermines the applicants' assertion.

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[16] Applicants submission, p15

[17] Reserve Bank of Australia, *Notes on Bank Fees in Australia* May 2000

[18] Reserve Bank of Australia, *Payment System Statistics*

[19] Applicants submission, p16

5.3 Public benefit of more flexible interchange fees

The applicants assert that there will be public benefit arising from increased 'flexibility' in setting interchange fees. This is a novel proposition that, in effect, any price fixing arrangement has a public benefit because it makes it easier for everyone to agree changed prices. That this could be interpreted as a public benefit appears to rely on an underlying assertion that there is some problem with the current arrangement; in this case the applicants identify two 'problems'.

The first problem identified is the 'difficulty of renegotiating' bilateral agreements 'creates an inertia that discourages any review and change of interchange fees'[20]. Caltex notes that the applicants provide no evidence of any such inertia or of fees failing to move toward costs over time. Nor is it easy to see that it is more flexible when at least 75% of the parties to the multilateral agreement must still agree.

The second problem identified is that the *'capacity of financial institutions to finance system-wide expansion or improvements in the EFTPOS network may be constrained by the loss of interchange fee revenues'*; under proposed arrangements system wide change could be negotiated far more easily through an appropriately set 'non-zero' interchange fee[21]. There is no evidence presented that there has been difficulty funding system wide changes; indeed, the well developed Australian EFTPOS system and the investment that Caltex and others have made belies any such conclusion.

The applicants seek authorisation for a zero interchange fee arrangement while reserving flexibility to move to a non-zero interchange fee at any time. In Caltex's view, the Commission should be deeply concerned by an arrangement which would allow the applicants to revisit EFTPOS interchange fees in the future with no methodology agreed now; cost-based or otherwise. Nor is any transparent process proposed.

5.4 Public benefit of making entry as a new issuer or acquirer easier

The applicants argue that removing price as a component of the bilateral negotiations of interchange agreements will 'ameliorate the extent of natural barriers to direct entry into the EFTPOS market'[22]. It is difficult for Caltex to comment on this assertion because it is not a party to any of the many bilateral agreements which have been entered into over time between acquirers and issuers. However, Caltex submits that:

(a) bilateral arrangements will still be necessary in order to set out all of the various technical arrangements for physical interfaces required between principals and other non-technical commercial issues; and

(b) there is no evidence presented by the applicants that price negotiation has been a 'natural barrier' to direct entry as a principal to the EFTPOS market. Not surprisingly, the applicants note that this is a theoretical[23] possibility only.

Caltex submits that negotiation of price is very unlikely to have been or be in the future a barrier to entry into the issuer/acquirer market.

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[20] Applicants submission, p22

[21] Applicants submission, p22

[22] Applicants submission, p23

[23] Applicants submission, p19

6. Public detriment

6.1 Investment in EFTPOS infrastructure

Caltex is a major provider of EFTPOS infrastructure in Australia, having made a capital investment in excess of $[confidential] since 1991. In 2001, Caltex outlets processed more than [confidential] EFTPOS transactions. The applicants have conceded in their submission that use of EFTPOS in Australia was spurred by acceptance at petrol retailers, and Caltex has been at the forefront of initiatives that have resulted in the Australian EFTPOS system being world class.

Caltex was able to invest in EFTPOS infrastructure because it was able to negotiate a network access fee with an acquiring bank for the use of its infrastructure, which delivered to Caltex a commercial rate of return. Acquirers were willing to pay a network access fee because they were saved from making the investment themselves. The contracts provide certainty in relation to future investment decisions. As discussed, there was a competitive tendering process by acquirers for the Caltex business which involved negotiation in a competitive context of the network access fee the acquirer was prepared to pay for the use of that equipment and infrastructure.

The public benefits which this competitive process delivered were considerable. As noted, the Australian EFTPOS system is considered to be '*best in the world in terms of quality, convenience, safety, technological advancements, overall cost, reliability, processing spread and increased efficiency*'[24]. In addition Australia has the highest penetration of EFTPOS terminals in the world.

Caltex estimates that capital expenditure in excess of $[confidential] will be required over the next [confidential] years to maintain its cards infrastructure and update it to meet market demand. While it is able to negotiate a network access fee with an acquirer to cover its investment, Caltex has certainty in relation to an acceptable return on that capital investment. That certainty will not exist if authorisation is granted.

[confidential].

This real and harmful consequence of the applicants' proposal is acknowledged by them in the submission. They require the flexibility to revert back to a non zero interchange fee (but one set multilaterally rather then bilaterally) because '*the capacity of financial institutions to finance system wide expansion or improvements in the EFTPOS network may be constrained by the loss of interchange fee revenues*'. In Caltex's view this outcome is a necessary consequence of the applicants' proposal.

6.2 Maintaining integrity of the EFTPOS system

What is fundamentally at risk if the proposed arrangement is authorised is the ongoing health of Australia's world class EFTPOS system. If the system degrades so that public confidence in the system is undermined then consumers may move to other payment systems. The current healthy position has not been reached by accident; it is a consequence of the investment that major

[24] *Australia's EFTPOS. Submission to the European Commission Inquiry into the Visa multilateral interchange fee*, Manuel Rio (Financial System Expert), Paris, March 1999 (unpublished).

retailers, such as Caltex, have been prepared to make over the years, behaviour which has been itself driven by the readiness of acquiring banks to pay for the use of that infrastructure.

The zero interchange arrangement will necessarily lead to changes in investment behaviour and put the existing system at risk. One need only compare the current highly secure PIN- operated EFTPOS system in Australia with the signature-based high fraud system in the United Kingdom to realise what consequences may flow from a fall of investment in EFTPOS infrastructure.

Caltex submits that the Commission should look to the UK as a warning as to how delays in investment (due to the prolonged negotiation between the British Retail Corporation and the financial institutions) or the adoption of lower cost options have widened the gap between the UK system and world's best practice. The proposed arrangement if authorised carries with it a significant risk that Australia might end up in a position, like the UK now, significantly diverging from world best practice because investment decisions are delayed or cancelled.

It should also be noted that the UK acquiring market is highly concentrated with NatWest Streamline and Barclays Merchant Services having together a market share of around 65%. It is no coincidence that these two acquirers have their own processing infrastructure where competitors must use outsourced processing systems provided by EDS and First Data. There has been little incentive to enter the acquisition market by developing new and better processing systems.

Caltex submits that the Australian interchange fee model has resulted in a superior system, with a greater degree of ubiquity and consumer confidence than the UK model. Removing the incentive to invest in acquiring infrastructure runs a significant risk of stalling the development of the Australian debit card payments system.

6.3 Free rider consequences

The proposed arrangement is designed to move costs from issuers to merchants and ultimately consumers. The network access fee currently paid to merchant networks is funded by the issuer through the interchange fee; so the costs are ultimately borne by the issuers whose cardholders benefit from use of the EFTPOS system. In addition, pending upgrades to card security will primarily benefit issuers, not the acquirers or merchants and yet the proposed arrangement will make merchants and ultimately consumers pay while issuers reap the benefits of reduced card fraud. Under the proposed arrangements the 'user-pays' principle would be eliminated and replaced with an arrangement where the costs are met by merchants and ultimately consumers while the benefit accrues to card issuers. Caltex submits that introducing such a distortion by giving one class of participants a free ride in the payment system cannot be in the public interest.

If the authorisation is granted, small debit card issuers who have made no investment in EFTPOS infrastructure (and who currently pay a fee to use that infrastructure) will be able to use that infrastructure at no charge, while Caltex (which has made a considerable investment in EFTPOS infrastructure) will be paying a fee for transactions conducted over the infrastructure that it owns. The proposal lacks commercial reality and is unsustainable.

7. The RBA / ACCC Joint Study

7.1 Summary

The applicants rely almost exclusively on the data and reasoning of the Joint Study. However, the Joint Study does not provide any basis upon which the ACCC could be satisfied that the public benefit of a price fixing arrangement in relation to debit card interchange fees outweighs the public detriment of such an arrangement.

7.2 The Applicants rely heavily on the Joint Study

The very first words of the application recite that it '*results from a review of interchange fees*' following the Joint Study. The 'problem' identified by the Applicants to which a multilateral price fixing arrangement is proposed as an answer is based solely on the problem perceived by the Joint Study[25].

The public benefit of increased use of EFTPOS is expressed to be 'in line with the conclusions of' the Joint Study[26] and the Applicants claim that 'on the basis of the reasoning of [the Joint Study], this gives rise to a public benefit because the current balance of costs borne by EFTPOS users is already distorted'[27]. Similarly, the benefit of more flexible interchange fees is expressed as a 'response to the conclusion of the [Joint Study] that competitive pressures have not been sufficiently strong to bring interchange fees into line with costs'[28].

The concluding paragraphs of the application demonstrate most clearly the heavy reliance placed by the applicants on the Joint Study to support the application[29]:

> *The proposed contract will give rise to significant public benefits. These public benefits are effectively those identified by [the Joint Study], and subsequently in statements by the RBA, as following from the setting of interchange fees at zero.*

7.3 Defects of the Joint Study as a basis for authorisation

The Joint Study suffers from a number of defects such that it cannot be relied on in an application for authorisation.

(a) *The starting point and approach of the Joint Study*: The starting point of the Joint Study was that there needed to be a convincing case to retain the existing system. Related to that conclusion was the observation that none of the participants in the Australian debit card network could provide a formal methodology or empirical evidence to support either the existing direction and level of interchange fees '***or a change in these arrangements***'[30]. In

[25] Applicants submission pp9-11

[26] Applicants submission p21

[27] Applicants submission p22

[28] Applicants submission p22

[29] Applicants submission p24

[30] Joint Study, p66 (emphasis added)

contrast, the starting point for an authorisation is that the proposed new price fixing arrangement must be justified on public benefit grounds.

(b) *The purpose of the Joint Study*: Although it is nowhere clearly expressed, Caltex submits that the Joint Study was only ever intended as a preliminary analysis of a number of payment systems. In relation to ATMs and credit cards further detailed studies and consultation have followed before any further regulation has been justified. Such a preliminary analysis is not a suitable evidentiary foundation for the Commission to be satisfied.

(c) *The Joint Study is old:* The Joint Study is now nearly three years old and used data relating to an even earlier time. The applicants do not provide any further or up-to-date information.

(d) *The role of merchants*: The Joint Study did not consider properly data from or the role of merchants as a party in the debit card payments system. For example, in looking at costs the Joint Study took into account bank-provided processing infrastructure but not the costs of merchant provided infrastructure. In addition, no data was collected from merchants upon which the likely effects of a zero interchange model could be properly assessed.

(e) *Data defects*: There were defects and inexplicable deviations in the data collected by the RBA and ACCC which lead to the conclusions of the Joint Study[31]. Caltex submits that more rigorous collection and analysis of data would be required before the Commission could be 'satisfied' of public benefits for the purposes of this application.

(f) *Incorrect findings*: The Joint Study's analysis of international practice regarding debit card interchange fees was incorrect in some key respects. In particular, the Joint Study examined the direction of debit card interchange fees in other jurisdictions and concluded that Australia is '*unique*'[32]. That conclusion was incorrect. South Africa and New Zealand both have arrangements whereby interchange fees flow to acquirers, very similar to the current Australian scheme. In addition, in other countries (such as Canada) payments (although not characterised as 'interchange' payments) are made by issuers to acquirers in recognition of the costs of acquisition.

(g) *Credit card reforms*: The Joint Study's main conclusion was that there was a distortion or imbalance between debit and credit systems. Since the Joint Study, the Reserve Bank has designated the credit card payment system and established a number of reforms to remove those distortions. Whether the conclusion of the Joint Study in relation to debit interchange would be the same now, in light of the changes to credit card interchange, is a moot point.

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[31] For example, where participants to the Joint Study did report authorisation costs on the issuing side there was significant variation and '*the study could not identify an obvious reason for this*' (Joint Study, p64)

[32] Joint Study, p66

Further information

8. Contacts

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